BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott	Chair
Ellen Gavin	Commissioner
Marshall Johnson	Commissioner
LeRoy Koppendrayer	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of a Commission Investigation into the Issues Raised by New Access Communications Regarding the Application of Qwest's Avoided Cost Discount to its Win Back Tariff	ISSUE DATE: December 20, 2002 DOCKET NO. P-421/CI-02-582 ORDER REJECTING WIN BACK TARIFF

PROCEDURAL HISTORY

State and federal law direct Qwest to permit competing telecommunications providers to interconnect with Qwest's network, and to permit them to buy Qwest's services at wholesale rates for resale to retail customers.[1] The wholesale price of Qwest's services is determined "on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier."[2] Both state and federal law prohibit Qwest from imposing unreasonable or discriminatory restrictions or limitations on the resale of its wholesale services.[3]

On December 11, 2001, the Commission approved an avoided cost discount rate of 17.66% for Qwest wholesale services provided after February 7, 2000.[4]

On March 11, 2002, New Access Communications, LLC (New Access), a Minnesota-based reseller, filed a Request for Clarification seeking clarification of the applicability of the 17.66% avoided cost discount to Qwest's "Business, Residence and Toll Competitive Response Program" (Win Back tariff). In the tariff, Qwest offers to waive certain charges when a customer that had abandoned Qwest's services in favor of a competitor agrees to return to Qwest.

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[1] 47 U.S.C. § 251(c); Minn. Stat. § 237.16.

[2] 47 U.S.C. § 252(d)(3); see also 47 C.F.R. §§ 51.501-51.717.

[3] 47 U.S.C. § 251(b)(1); 47 U.S.C. § 251(c)(4); Minn. Stat. § 237.121(a)(5).

[4] *In the Matter of a Further Commission Investigation of Avoided Cost Discount of U S WEST Communications (now Qwest)* Docket No. P-999/CI-99-776 ORDER ACCEPTING THE PROPOSED RESOLUTION. This discount rate did not pertain to competitors subject to the Qwest/MFS interconnection agreement which contains a different negotiated discount rate.

On April 26, 2002, Qwest filed to amend the business Win Back tariff to permit the service to be resold, effective May 28.[5]

On May 2, 2002, the Commission opened the current docket to investigate the issues raised by New Access' request for clarification.

By July 2, 2002, the Commission had received comments from the Association of Communications Enterprises (ASCENT), formerly Telecommunications Resellers Association;[6] Eschelon Telecom, Inc. (Eschelon); the Minnesota Department of Commerce (the Department); New Access; Qwest; the Residential and Small Business Utilities Division of the Minnesota Office of the Attorney General (RUD-OAG); Stonebridge Communications (Stonebridge); and WorldCom, Inc. (WorldCom).

By July 17, 2002, the Commission had received reply comments from New Access and Qwest.

The matter came before the Commission on September 19, 2002.

FINDINGS AND CONCLUSIONS

I. THE WIN BACK TARIFF

On February 24, 1999, US WEST Communications, Inc. (US WEST), predecessor to Qwest, filed its Win Back tariff to take effect on March 26, 1999. The program offered to waive certain costs for customers that leave US WEST for another telecommunications service provider and then return to US WEST. The tariff offered residential customers a waiver of certain one-time charges plus two months of monthly charges. A customer that also agreed to take US WEST's intraLATA toll service could receive an additional annual discount on intraLATA charges.

The Win Back tariff made similar offers to residential and business customers, but there were some differences. Business customers, but not residential customers, could be billed for all the charges waived under the tariff if they cancelled their Qwest service within 12 months. And initially the business tariff was declared unavailable for resale. Qwest changed this aspect of the tariff after New Access had asked to open the current investigation.

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[5] *In the Matter of Qwest's Business Competitive Response Program*, Docket No. P-421/AM-02-602.

[6] According to its filing, ASCENT is an industry organization founded "to assure that all service providers, particularly entrepreneurial firms, have the opportunity to compete in the communications arena...."

II. LEGAL STANDARD

Historically, Minnesota's public policy did not facilitate local telephone competition.[7] But in the mid-1990s, state and federal law changed to promote competition in the local telecommunications market. Laws 1995, chapter 156 (Minnesota Telecommunications Act of 1995); the federal Telecommunications Act of 1996[8] (the 1996 Act). Both pieces of legislation contemplated that new telecommunications providers would compete with the incumbent local telephone company, and with each other, to provide local telecommunications services to retail consumers. To this end, the 1996 Act directs an incumbent local telephone company –

> (A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and
>
> (B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service....[9]

Federal and state law prohibit Qwest from engaging in unreasonable discrimination.[10] For example, Minnesota Statutes § 237.09, subd. 1 says:

> No telephone company, or any agent or officer thereof, shall, directly or indirectly, in any manner, knowingly or willfully, charge, demand, collect, or receive from any person, firm, or corporation, a greater or less compensation for any intrastate service rendered or to be rendered by it than it charges, demands, collects, or receives from any other firm, person, or corporation for a like and contemporaneous intrastate service under similar circumstances.

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[7]Minn. Stat. § 237.16, subd. 2 (1994); see also *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Common Carrier Bureau (CC) Docket No. 96-98, FIRST REPORT AND ORDER, FCC 96-325, 11 F.C.C.R. 15,499 (rel. August 8, 1996) (*Local Competition Order*) ¶ 1:

> Historically, regulation of this industry has been premised on the belief that service could be provided at the lowest cost to the maximum number of consumers through a regulated monopoly network. State and federal regulators devoted their efforts over many decades to regulating the prices and practices of these monopolies and protecting them against competitive entry.

[8] Pub. L. No. 104-104, 110 Stat. 56 (codified throughout title 47, United States Code).

[9]47 U.S.C. § 251(c)(4). See also Minn. Stat. § 237.16.

[10]See, for example, 47 U.S.C. § 251; Minn. Stat. §§ 237.07, subd. 2; 237.081, subd. 4; § 237.09, subd. 1; 237.121(a)(5); 237.14; 237.60, subd. 3.

Discrimination can arise in the manner in which a telecommunications provider restricts the resale of its services. Federal and state law bar unreasonable restrictions on resale.[11] Resale is a critical market entry tool for new competitors and a critical network completion tool for established competitors. Unconstrained resale is essential to the development of a competitive local telecommunications market. For this reason, federal law makes all restrictions on resale presumptively invalid.[12] Any tariff affecting resale therefore triggers the highest level of scrutiny from this Commission.[13]

III. POSITIONS OF THE PARTIES

A. Support for the Win Back tariff

Qwest claims that the Win Back tariff is a very narrow offering, waiving certain charges when a local service provider attracts its own customers back. It is a neutral tariff, benefitting a reseller's customer in the same way, with the same terms and conditions, as it benefits Qwest's own retail customers.

Qwest argues that the avoided cost discount should not apply to the Win Back tariff. Qwest argues that the wholesale avoided cost rate should apply to "the relevant 'listed' Minnesota tariff rates."[14] The Win Back tariff merely waives Qwest's right to collect revenues; it does not create a new tariffed rate, according to Qwest, and therefore cannot be subject to resale at the avoided cost discount. While denying that it has any obligation to offer its Win Back tariff for resale, Qwest has agreed to do so, albeit without any wholesale discount.

Qwest argues that it offers the Win Back tariff in the hope that the revenues it forgoes will be recouped through future payments from the won-back customer. In making this offer, Qwest has placed some revenue at risk; Qwest suggests that competitors should be willing to incur the same revenue risks.

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[11]Minn. Stat. § 237.121(a)(5) and 47 U.S.C. § 251(b)(1) and (c)(4).

[12]*Local Competition Order* ¶ 939.

[13]See *In the Matter of Qwest Corporation's Refiling of its Proposed Tariffs Regarding Termination Liability Assessments as Applied to Resale Arrangements*, Docket No. P-421/AM-00-1165 ORDER REJECTING TARIFF/PRICE LIST REVISIONS (October 2, 2001) (*TLA Order*) at 11-12.

[14]Qwest Comments (June 19, 2002) at 6; Qwest Supplemental Comments (July 2, 2002) at 6.

B. Opposition to the Win Back tariff

ASCENT, the Department, Eschelon, New Access, RUD-OAG, Stonebridge and WorldCom (collectively, the opponents) each recommend changing or eliminating the Win Back tariff.

1. Application of the wholesale discount

As noted above, the Telecommunications Act of 1996 directs an incumbent local telephone company "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers...."[15] Because the Win Back tariff establishes rates for telecommunications services that Qwest provides at retail to subscribers, many opponents argue that section 251(c)(4) governs.

Specifically, they argue that the 1996 Act requires Qwest to offer its Win Back service for resale, and with the avoided cost discount. While Qwest argues that this obligation applies only to "the relevant 'listed' Minnesota tariff rates" and not to things like the Win Back tariff, the parties cite the Federal Communications Commission to support the opposite conclusion. According to the FCC,

> Section 251(c)(4) provides that incumbent LECs must offer for resale at wholesale rates "any telecommunications service" that the carrier provides at retail to noncarrier subscribers. This language makes no exceptions for promotional or discounted offerings, including contract and other customer-specific offerings. We therefore conclude that no basis exists for creating a general exemption from the wholesale requirement for all promotional or discount service offerings made by incumbent LECs. A contrary result would permit incumbent LECs to avoid the statutory resale obligation by shifting their customers to nonstandard offerings, thereby eviscerating the resale provisions of the 1996 Act.[16]

2. Anti-competitive effects

The opponents argue that the Win Back tariff has a disproportionately harmful effect on competitors. Qwest characterizes the tariff as a very limited offering,[17] reflecting the fact that it applies to a small percentage of Qwest's customers. But the tariff applies to nearly 100% of a competitor's customers, the opponents observe. As a result, Qwest can use the Win Back tariff to pursue most of a competitor's customers, but competitors cannot use the Win Back tariff to pursue most of Qwest's customers.

Some opponents argue that there are practical limits on how many times a customer can be persuaded to change local service providers. Some opponents cite testimony declaring that once a customer is persuaded to leave a provider – with all the attendant administrative burdens of changing a local service provider – and then is persuaded to rejoin that provider – again with all

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[15] 47 U.S.C. § 251(c)(4)(A).

[16] *Local Competition Order* at ¶ 948.

[17] Qwest Comments at 6 (June 17, 2002).

the attendant burdens – that customer will be extremely reluctant to change providers for a third time. By virtue of Qwest's status as the incumbent, Qwest is virtually always in the position of inducing the customer to make the second change in local service providers.

Finally, the Win Back tariff has the effect of depressing competitors' revenues. The tariff compels competitors to design all their rates in anticipation of Qwest seeking to use the Win Back tariff on their customers. This has tended to depress competitive revenues and activities.

3. Discrimination

Win Back's critics note that the Win Back tariff does not offer a new service. It merely offers existing services to certain customers at a reduced rate. In short, it discriminates between telephone subscribers who have left Qwest and all other telephone subscribers. The competitors argue that this is not a reasonable basis for discrimination.

Also, the Department argues that Qwest exploits its role as wholesale provider to help its retail operation. As the administrator of the wholesale network, Qwest's wholesale operation must implement any resale customers' choice to change subscribers. As a result, Qwest's wholesale operation must learn of customer changes early. Resellers may not learn that they have lost a customer until 40 days later. But Qwest's wholesale operation may give its retail operation faster notice that a customer has left Qwest, permitting Qwest's retail operation to initiate Win Back efforts faster. The Department cites accounts of Qwest initiating Win Back efforts even before a customer had disconnected service from Qwest.

IV. COMMISSION ACTION

Having reviewed the record of this case and provided opportunity for all parties to be heard, the Commission finds the arguments of the tariff's opponents persuasive. While the Win Back tariff may appear neutral on its face, it has a disproportionately harmful effect on competitors. The Win Back tariff produces three types of discrimination:

- It discriminates against Qwest's wholesale customers.
- It discriminates among Qwest's wholesale customers.
- It discriminates among Qwest's retail customers.

The Commission will address each type of discrimination below.

A. Discrimination Against Wholesale Customers

The Commission concludes that the Win Back tariff discriminates against Qwest's wholesale customers, which also happen to be its retail competitors. In short, the tariff is anti-competitive.

While Qwest defends the tariff as being a very narrow offering, it is precisely this quality that generates most of the anti-competitive effects. By its terms, a provider may only use the tariff to provide service to a returning customer. Due to Qwest's role as the incumbent monopolist, nearly every phone subscriber was a customer of Qwest at some time. Competitors, lacking the advantage of incumbency, cannot make a similar claim. As a result, Qwest can use the Win Back tariff to pursue most of a competitor's customers, but competitors cannot use the Win Back tariff to pursue most of Qwest's customers. This fact produces the following consequences:

First, the Win Back tariff produces a price squeeze. A "price squeeze" results when a monopolist wholesale supplier sells a wholesale product to retailers at a price that is inappropriately close to its own retail price.[18] In this way, the wholesale monopolist is able to extend its power into the retail market. Due to the Win Back tariff's limited scope, most competitors would not qualify to buy Win Back service to serve most customers. Instead, a reseller must seek to lure a typical customer by reselling Qwest's standard residential and business service. While the reseller may buy those services at a 17.66% discount, those services still cost more at wholesale than Qwest's Win Back offer – free service – costs at retail. A price squeeze results. While customers may benefit from lower retail prices in the short term, they suffer in the long run when competitive alternatives fail to materialize.

Second, competitors find that they must incur the costs of acquiring customers twice -- once to attract them initially from Qwest, and a second time to attract them again if they migrate back to Qwest. In contrast, Qwest incurred no cost to attract most of its customers initially due to its position as the incumbent monopolist. As a result, Qwest only incurs the cost of attracting a customer once, when it tries to woo the customers back from the competitors. This disparity places competitors at a disadvantage.

Third, the Win Back tariff has the effect of depressing competitors' revenues more than it depresses Qwest's revenues. Qwest is able to reduce its rates for some customers, confident in the knowledge that the vast majority of its own customers continue paying the higher rate. Competitors, in contrast, lack such a regular revenue stream to support their promotional activities. To the contrary, they know that nearly all of their customers are prey to the Win Back tariff, and must adjust nearly all of their offerings accordingly. The effects of this tariff are clearly anti-competitive.

The Commission appreciates Qwest's argument that competition is supposed to result in lower prices. But the Commission observes that Qwest could have produced the same salutary effect on prices by offering a tariff that is not restricted exclusively to former customers. The Commission is disinclined to approve conduct that may harm competition where less-harmful alternatives remain unexplored.[19]

But not all of the anti-competitive effects of the Win Back tariff flow from its narrow scope. The tariff's vague language also invites discrimination among customers who qualify for the tariff. The tariff states the maximum offer that Qwest could make a potentially-returning customer, but otherwise gives Qwest unbridled discretion to decide how much to offer any given customer. More than three years after the Win Back tariff was filed with the Commission, the Department notes that Qwest's guidelines for implementing the tariff remain under development.

Finally, the Commission observes that the business Win Back tariff contains a termination liability clause. The clause reimposes all of the costs waived by the Win Back tariff if a customer abandons Qwest's service within a year. As the Commission has noted previously, such clauses

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[18] *Federal Power Commission v. Conway Corp.*, 426 U.S. 271 (1976).

[19] See *TLA Order*, *supra* at 13 (even where a utility's tariff serves a legitimate purpose, the Commission may reject it if the utility fails to explore less harmful ways to serve that purpose).

can have anti-competitive effects in that they tend to bind a customer to the monopolist at a time when public policy is focusing on opening the local service market to competition.[20]

B. Discrimination Among Wholesale Customers

By limiting the application of the Win Back tariff exclusively to former retail customers, Qwest interferes not only with a competitor's ability to compete with Qwest but also with a competitor's ability to compete with other competitors.

A competitor's customers will be pursued not merely by Qwest but by other competitors. In the likely event that the customer had previously received service from Qwest, Qwest could use its Win Back tariff to lure the customer. But due to the tariff's restrictions, it is likely that no other service provider would qualify to offer Win Back service to the customer. After Qwest wins the customer back, the company that lost the customer might qualify to offer resold Win Back service to the customer in an attempt to again lure the customer's business. But typically all of the other competitors would still be excluded from offering Win Back service to the customer. In short, the tariff's arbitrary limitation results in distorting the market among new entrants.

C. Discrimination Among Retail Customers

Finally the Commission faces the question of whether customers who no longer receive Qwest's service are "under similar circumstances" to customers who do, or to customers who had never received Qwest's service. As the Supreme Court noted, "Regardless of the carrier's motive – whether it seeks to benefit or harm a particular customer – the policy of nondiscriminatory rates is violated when similarly situated customers pay different rates for the same services."[21]

Of course, some circumstances do warrant treating different customers differently. A telecommunications provider might charge customers differently that are in different customer classes. A provider might charge customers differently on the basis of the cost of providing service – including cost differences that arise when a customer agrees to receive an unusual volume of service, or service for a different term, or a service that is subject to different local taxes, fees or surcharges.[22] And a provider may give employees a discount on their phone service as a form of compensation.[23]

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[20]See, for example, *id*.

[21]*AT&T v. Central Office Telephone*, 524 U.S. 214, 223 (1998) (citing *MCI Telecommunications Corp. v. American Telephone and Telegraph Co.*, 512 U.S. 218, 229 (1994)).

[22]Minn. Stat. § 237.60, subd. 3.

[23]Minn. Stat. § 237.14.

But in this case, the Commission cannot determine a legitimate reason for Qwest to target a tariff solely at former customers. The distinction is not cost-based; Qwest assures the Commission that the cost of providing its Win Back service is no less than the cost of providing local service generally. The distinction is not based on customer class. The distinction is not being offered as an employee discount.

The distinction appears to be designed solely to segment the market to facilitate price discrimination. Simply put, Qwest has reduced its price to attract more customers, but Qwest does not want to let existing customers receive the benefit of the price reduction, and does not want to provide competitors with an opportunity to resell a broader offering. As a result, customers that are otherwise identically situated end up making different contributions towards Qwest's operating costs. When pursued by a monopolist, the Commission finds that this practice is unreasonably discriminatory because it accords different treatment to customers that receive service under similar circumstances. Consequently, the Commission concludes that the tariff violates Minnesota Statutes §§ 237.07, subd. 2; 237.081, subd. 4; 237.09, subd. 1; 237.121(a)(5); 237.14; and 237.60, subd. 3.

D. Conclusion

The Commission has previously wrestled with the effect of the incumbent's promotional activities on the development of competition. When the Commission rejected U S WEST's proposed promotion in the *SingleNumber Service case*, the Commission reasoned as follows:

> This marketing strategy and its resulting competitive advantage are available to U S WEST only because it is currently the monopoly provider.
>
> To allow U S WEST or any other incumbent provider to exploit its monopoly status and throw up eleventh hour barriers to customers changing companies would directly contravene state and federal policies opening the local telecommunications market to competition. It would complicate, prolong, and perhaps jeopardize the already complex process of transforming a monopoly environment into an effectively competitive one.[24]

Applying the same reasoning to the Win Back tariff, the Commission will reach the same conclusion. This Commission is charged with removing barriers to competition and protecting customers from unreasonable discrimination. By writing a backwards-looking condition into the tariff, U S WEST was able to exploit the advantages of its historical status as the monopoly provider, and to extend those advantages into the future. This situation must not endure.

For the foregoing reasons, the Commission finds the Win Back tariff to be unreasonably discriminatory and anti-competitive. Finding no compelling countervailing reason to sustain the tariff, the tariff will be disapproved.

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[24]*In the Matter of U S WEST Communications, Inc's Proposal to Offer a Rate Stability Plan for SingleNumber Service,* Docket No. P-421/EM-95-1245, ORDER REJECTING RATE STABILITY PLAN (May 7, 1996).

ORDER

1. Qwest's Business, Residence and Toll Competitive Response Program is rejected.

2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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